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SUBJECT: SEASON OF SCANDALS: PARTIES SQUIRM IN AP AND KERALA

11. (SBU) SUMMARY: The Volkswagen scandal in Andhra Pradesh and Canada's SNC Lavalin scandal in Kerala continue to make headlines. The former involves the questionable transfer of government funds to a dubious company that featured the VW initials but no further relationship with Volkswagen, in an effort to secure Volkswagen FDI for AP. The latter revolves around the Comptroller and Auditor General's reported criticism that Canadian company SNC Lavalin reneged on its promise to grant \$23 million aid to a Kerala Cancer hospital in return for a power project secured without competitive bidding. The companies involved have reacted very differently to the outbreak of scandals: VW quickly took corrective actions, while Lavalin remains inexplicably quiet. END SUMMARY.

WHEN GOVERNMENT FILES MOVED FAST...

12. (U) The Congress government of Andhra Pradesh (GoAP) has come under opposition fire for the transfer of \$2.7 million to a dubious company, Vasishta Wahan, apparently set up by the company's India project head, Helmut Schuster and his associates. This transfer of money took place in the context of the VW's four-year-long negotiations with GoAP to set up a car plant in Vishakapatnam. Ostensibly as equity participation in a joint venture, the GoAP ordered the transfer of money from Andhra Pradesh Industrial Investment Corporation to Vasishta Wahan's Indian bank account in January 2005. The deal, without even a Memorandum of Understanding or formal approval from the Volkswagen board, hit the headlines in July following exposes in German newspapers. Shuster soon after lost his dual job as Chief of Human Resources at Skoda and VW's India project head.

WE WERE DECEIVED, SAYS AP CHIEF MINISTER

13. (U) On June 22, when VW headquarters officially informed GoAP of the exit of Shuster and VW's India Advisor Ashok Jain from the company, GoAP began frantic efforts to recover the money and escape embarrassment. It was too late. The government soon discovered that the money was no longer with the bank and VW's official spokesmen denied any VW links with Vasishta Wahan. "It is now clear that Schuster deceived my government", Chief Minister Y.S. Rajashekhara Reddy told a private TV channel, "I am confident that the probes in Germany and by the CBI (Central Bureau of Investigation) will confirm this fact."

RESPONSIVE VW HELPS AP'S DAMAGE CONTROL

14. (U) VW's quick and effective assistance to GoAP's damage control efforts helped. On July 21, Volkswagen issued a public statement that the company will repay the two million Euros to AP. "The company is thus assuming responsibility for the damages caused by the suspected illegal dealings of the former Head of Human Resources at Skoda, Helmut Schuster," the statement said. The statement added that the group will "call to account those responsible for the damage both inside and outside the company." VW sent former German Ambassador to India, Frank Elbe, as the company's special envoy. Elbe met Chief Minister Reddy in Hyderabad on August 1, reassuring the state of the company's continued interest in Andhra Pradesh.

15. (U) Chief Minister Reddy's decision to leave the investigation to the federal agency, CBI, and to shift Industry Minister Botcha Satyanarayana to another department also helped mitigate the damage. The CBI has arrested Ashok Jain and conducted searches at associated premises. Chief Minister Reddy's political colleagues, meanwhile, keep harping on the Opposition's attempted deals with the VW while they were in power. Senior Congress leader and Municipal Administration Minister Koneru Ranga

Rao told Post that Telugu Desam Party leader Chandrababu Naidu had promised to buy 50 ambulances from Volkswagen at five million rupees (\$120,000) a piece to secure the \$400 million car project.

QUESTIONS REMAIN ON THE 'HOAXWAGEN STORY'

16. (U) All these efforts, however, are unlikely to absolve GoAP of what the media calls, the 'Hoaxwagen story' in the minds of the public. It is widely believed that the money was probably paid to Vasishta Wahan as "facilitation charges", euphemism for bribe, and not as equity participation. Newspapers have also raised allegations on the shunted minister Satyanarayana's and his brother Muralikrishna's private real estate and other business deals in connection with Volkswagen investment. The Frontline magazine of July 30 raised several questions for the CBI to answer: "Was the government conned by a glib operator? Why did the government release the money to Vasishta Wahan and not to Volkswagen, and that too, without an MOU? Could such a payment be made to a company whose authorized share capital is just Rupees 100,000 and which operates from a one-room office in Delhi?"

A CANADIAN DEAL THREATENS KERALA COMMUNIST LEADER

17. (SBU) If it is the ruling party that is facing the allegations in AP, it is the Opposition Communist Party of India Marxist (CPI-M) that is on trial in Kerala. The Party State Secretary Pinarayi Vijayan is caught in the middle of a controversy involving a contract awarded to SNC Lavalin of Canada in 1996-97, when he was the state Energy Minister. In the context of an ongoing power struggle within the CPI(M), Post's journalist contacts believe that the allegations might threaten Vijayan's Chief Ministerial prospects. Vijayan is widely considered to be relatively more open to FDI and private sector activity than CPI-M alternatives.

BIGGEST SCAM IN KERALA'S HISTORY, SAYS CONGRESS

18. (SBU) Congress party leaders allege that Vijayan, after a 1996 visit to Canada, converted a previous consultancy service agreement with SNC Lavalin for the modernization of three hydroelectric projects (Pallivasal, Chengulam and Panniyar) into a Rupees 3.74 billion fixed price contract without global tenders. Senior Congress leader and legislator M.M. Hassan told Post that that Comptroller and Auditor General in his draft report has mentioned that the entire expenditure in this project was wasteful as it failed to enhance production. According to Hassan, the CAG also pointed out that Lavalin had gone back on its promise to provide a grant of Rupees 983 million (\$23 million) for Malabar Cancer Center in return for the contract, and gave only Rupees 89.8 million (\$2.1 million). Hassan believes that SNC Lavalin might have paid all the money, which the intermediaries probably siphoned off. He hinted to Post that the money might have gone into the launching of the CPI(M)'s private TV channel company, Kairaly. Hassan described the SNC Lavalin deal as the biggest scam in the history of the state.

COMMUNIST PARTY INFIGHTING PROVIDES AMMUNITION

19. (SBU) CPI(M) Central Committee Member and prominent Kerala leader M.A. Baby (Protect) told Post that his leader Vijayan is being pilloried for taking a proactive role in solving the energy problems of the state. "All he wanted was to go fast in solving serious energy crisis", Baby said. Ranji Kuriakose, a Kerala journalist who regularly writes on the scam, explained to Post that the issue has grown sensational in the context of the internecine power struggle within the CPI(M). "Vijayan's diehard opponent in the party, Achuthanandan, is helping his enemies in exposing the deal," says Ranji. Chief Minister Oommen Chandy has ordered a vigilance enquiry into the affair. Ranji, however, believes that the vigilance enquiry is not proceeding fast, perhaps to shield the ruling Congress party's former Energy Minister, Karthikeyan, who also might have had a part in the deal.

110. (SBU) Unlike Volkswagen, SNC Lavalin has taken no initiative in clearing its name. Hassan pointed out that SNC Lavalin is remaining silent, even as the controversy is raging in Kerala. Ranji has heard rumors that the Canadian High Commission has written to the GoK saying that the company has paid all it owes, but without going into the details of the payment.

COMMON LACK OF TRANSPARENCY; DIFFERENT REACTIONS

11. (SBU) COMMENT: Both the VW and SNC Lavalin episodes show how a lack of transparency in deals between multinational corporations and state governments can lead to serious issues of corruption. The companies have reacted differently. While VW's proactive steps clearly helped salvage its reputation, SNC Lavalin's silence, probably out of helplessness, could lead to a total loss of market in the region. In the case of VW, local politicians have learned another lesson too: In the eagerness to compete with neighboring states in securing FDI, one needs to be careful not to go too fast. END COMMENT
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